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**Guaranty Trust Company
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Acceptances

Place:

[New York]

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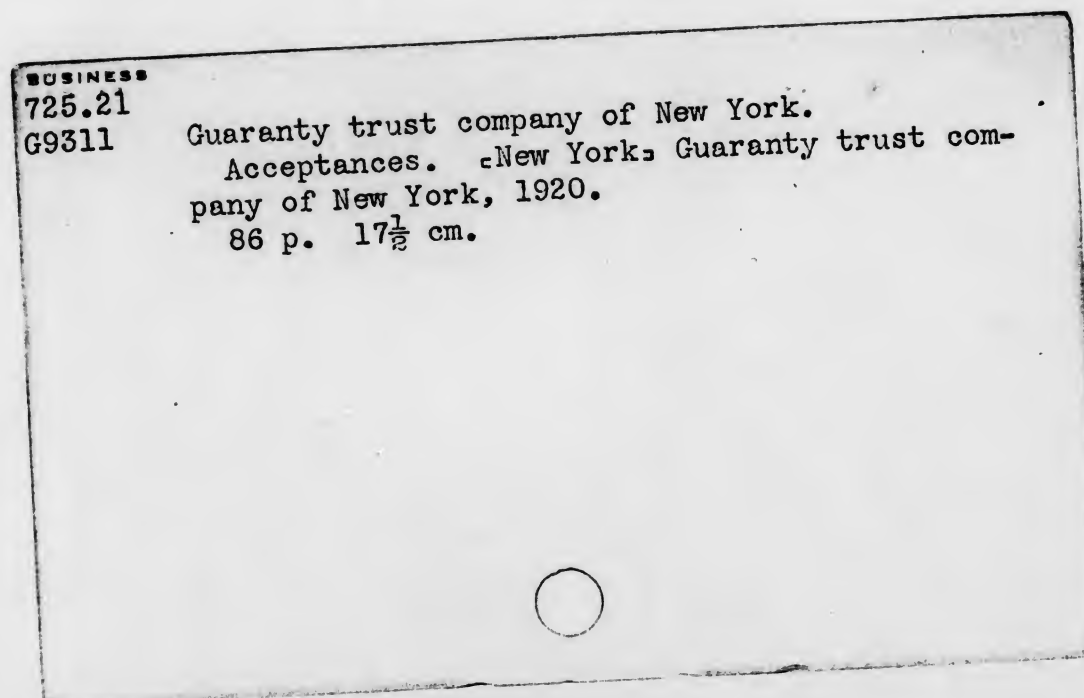
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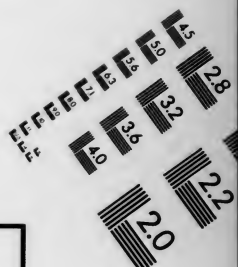
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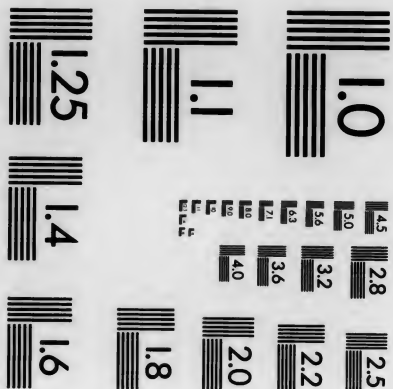
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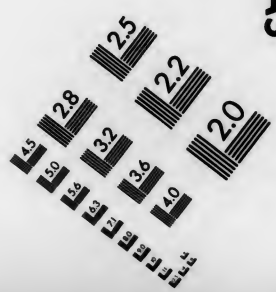
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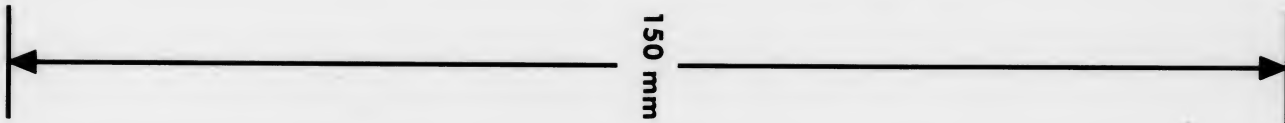
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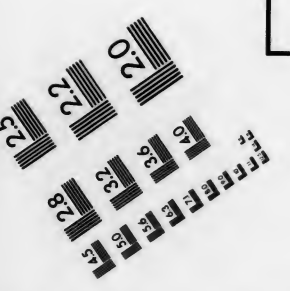


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Foreword

This booklet contains a discussion of the use and advantages of trade and bankers' acceptances, together with pertinent rulings and regulations of the Federal Reserve Board which are deemed to be of interest.

On October 25, 1920, the Federal Reserve Board issued revised regulations covering, among other things, the acceptance of drafts and bills of exchange by member banks; rediscounts under Section 13 of the Federal Reserve Act; open market purchases of bills of exchange, trade acceptances, and bankers' acceptances under Section 14; and operations of banking corporations formed under the Edge Act. These regulations, in so far as they apply to trade and bankers' acceptances, will be found in substance in this booklet.

November, 1920.

Acceptances

There are two kinds of acceptances—Trade Acceptances and Bank Acceptances.

Trade Acceptances

Use in Europe

In Great Britain and in many countries of Continental Europe practically every commercial transaction is financed by means of a time draft, or bill of exchange. The draft is drawn by the seller of the merchandise and presented to the buyer, who, if he finds it satisfactory, writes across its face the word "Accepted," signs his name, and returns the draft to the seller. It then becomes a trade acceptance—a sound, circulating medium of finance which ordinarily commands a low rate of interest and which the seller, if he desires, may discount at his bank.

Although European countries have long realized the many advantages of the trade acceptance over the open book account in financing commercial transactions, merchants in America have been slow to grasp and utilize

the opportunities offered by the acceptance method.

Not an Innovation in United States

The use of the trade acceptance in this country prior to the Civil War was more or less general, but after that conflict, the increasing financial disorganization and the risk attending the granting of long credits created a demand for cash which made the cash discount system so popular that it has since continued in favor. This led to the open book account. While the trade acceptance today is being used to a much greater extent than a few years ago, goods are still bought and sold largely on open account.

A very active and aggressive propaganda is being carried on throughout the principal commercial centres of the country in favor of trade acceptances, and their use has considerably increased. Many of the leading commercial and industrial concerns have adopted this new system of credit and most banks are inclined to purchase such two name paper arising from actual commercial transactions between the drawer and the acceptor.

Trade Acceptance Defined

A trade acceptance is a time draft or bill of exchange, drawn by the seller of goods on the buyer for the purchase price, and accepted by the buyer, payable on a certain date at a place designated on the face of the instrument. A trade acceptance amounts to a negotiable guarantee by the purchaser of goods that at a specified time and place, he will pay the purchase price. An acceptance being a negotiable instrument, the seller, by means of it, may obtain the use of the outlay it represents for further enterprises by selling it to his bank.

Distinguished from Sight Draft or Promissory Note

A note is ordinarily used to borrow money or to settle overdue obligations. A trade acceptance shows on its face that it is drawn by the seller on the purchaser of merchandise for the price of the goods. When accepted, it becomes a valid promise to pay on a specified date, a negotiable instrument equally as binding upon the person accepting it as his promissory note would be. As a

trade acceptance is an obligation of the buyer indorsed by the seller, the bank discounting it is secured by two names instead of by one name paper, as is the case with a promissory note.

Trade and bank acceptances are instruments of credit which should be employed in the financing of business and industry, in the moving of crops, and in numerous other ways, and American merchants should make use of them as the best method of carrying on both their foreign and domestic trade.

Method of Using

The seller desiring to use the acceptance method, in making out an invoice for a sale of goods, forwards with the invoice a time bill or draft drawn on the purchaser for the purchase price, payable at a specified date; or where the buyer makes several purchases of small amounts during the month, the seller in making up the monthly statement forwards with it a draft or bill made out for the total amount due. When the purchaser of goods receives the draft or bill he may pay

it at once, having deducted whatever is allowed as a discount for prompt payment in cash, or he may write across the face thereof the date and the words, for example, "Accepted—payable at Guaranty Trust Company of New York." The buyer then signs his name and returns the instrument to the seller. The latter either keeps it until a few days before it matures, when he sends it to his bank, which makes collection from the bank at which the instrument is payable, or if the seller desires funds, he may discount it at his bank or sell it in the open market through an acceptance dealer.

The place of payment is at the office of the buyer of the goods, namely, the acceptor, if no other place is designated. To facilitate the collection of trade acceptances the paper should be made payable at the acceptor's bank, and the banker and acceptor should make arrangements so that maturing acceptances are charged to the acceptor's account on the date of maturity. In most states, however, the banker may automatically charge maturing acceptances to his customer's account.

TRADE ACCEPTANCE Due SEP 18 1918

No. 2000 New York, N. Y. June 19 1918 \$ 1,000.00

Nineteen days after eight pay to the order of OURSELVES

One hundred and no/100 Dollars

The obligation of the acceptor hereof arises out of the purchase of goods from the drawer, maturity being in conformity with original terms of purchase. The drawee may accept this bill payable at any bank, trust company or banker's office in the United States which he may designate.

AC-ED To John D. Doe 1000 Madison Ave., Richard Roe & Co.

(Name of drawee) (Street address) (City) (Signature of drawee)

Payable at New York (City)

GUARANTY BANK OF NEW YORK (Name of Bank)

(Place of payment) (Designate Bank or Business Company)

(Signature of acceptor)

Trade Acceptance

When Not to be Used

In countries abroad where bills of exchange and acceptances have reached their highest development as credit instruments and circulating mediums, it has been the custom that they shall be issued for commercial purposes or against actual business transactions. They should represent current merchandise transactions connected with the purchase and sale of goods, and should not be given for overdue accounts or borrowed money. The custom in this country follows the rulings of the Federal Reserve Board respecting eligibility for discount and purchase by Federal reserve banks.

Open Account and Acceptance Methods Compared

Open Account Ties up Capital

The open account system with its indefinite time of payment is a business habit with many disadvantages. One defect is that it forces the seller to carry the financial burden of the buyer. The open account ties up the seller's invested or borrowed

capital for an indefinite period, during which he receives no stated compensation for it.

The trade acceptance does not lessen the advantage of the buyer. He obtains his credit for a definite instead of an indefinite period of time. It is of service to the seller, for if he happens to be in need of funds he can take the acceptance to his bank and readily discount it. This will enable him to have the use of the money. The bank—not the seller—carries the credit, and all parties to the transaction are placed on an equitable basis.

Trade acceptances are not meant to defer payment in ordinary transactions where the buyer usually pays cash on the spot or within ten days. They are not needed when business is done on that basis, and the buyer is not forced to use acceptances if he prefers paying cash and saving the discount allowed for cash payments.

Uncertainty of Open Accounts

As assets, open accounts are neither quick nor sure. They are frequently slow and uncertain of realization. Even the best of them

are seldom marketable for more than fifty per centum of their face value. In the form of eligible trade acceptances accounts may be converted into cash at a favorable rate of discount.

Unreasonable Extensions of Time

A disadvantage of the open account system is the ease with which payment may be postponed, thus enabling purchasers to abuse their credit by putting off the settlement of their obligations for long periods of time without even paying interest. This results from the fact that since the time of payment is usually not fixed, the privilege of obtaining an extension is regarded as a matter of course.

Costliness of Open Account System

The open account is costly. The expense involved in collecting slow accounts, in extensions of the time of payment, and in trade discounts—all characteristic of the open account system—constitutes, in the aggregate, a heavy tax on business. All these disadvantages are eliminated by the use of the trade

acceptance which gives stability to commercial credit and transforms deferred obligations into definite assets and liabilities.

Conveniences of Open Account Retained

The right to make partial payments, which is one of the conveniences of the open account, may be arranged with the bank; and if the trade acceptance cannot be conveniently met by the customer upon its maturity, the merchant, if he desires to help him, may do so by taking the customer's promissory note with interest. Thus the merchant granting the extension does so without the loss of interest, which results under the open account system. Since trade acceptances are not given for renewals or for old accounts, they should be settled with notes which draw interest.

Other Disadvantages Eliminated

Among other disadvantages of the open account method which will be eliminated by the general adoption of the trade acceptance may be mentioned the habit of over-buying and over-selling, the returning of goods and

cancellation of orders for trivial reasons, the taking of unwarranted discounts, the secret assignments of accounts and losses from uncollectible debts.

General Advantages of Trade Acceptances

Business Conditions Improved

The trade acceptance releases funds tied up in outstanding accounts, and invested capital acquires more liquidity under a system which offers negotiable paper in place of non-negotiable open book accounts. Relations between buyer and seller are vastly improved by paper which clearly defines their respective rights and obligations, and extravagance is checked by the constant reminder to the debtor that his credit is apt to be tested at any time.

Advantages to the Buyer

The buyer derives certain advantages from the use of the trade acceptance. It develops in him the habit of careful buying, enables him to judge how he stands financially and

what he can do with his capital, and it strengthens his credit. He is able definitely to fix the dates of his payments, thus developing a habit of promptness in fulfilling obligations.

The small buyer is better able to compete with larger firms since the trade acceptance gives him a better credit rating and places his business on a definite financial basis, which cannot be the case when his debts are in the form of open accounts with no means of ascertaining when they will be liquidated.

Advantages to the Seller

Sellers or manufacturers with limited capital, by the adoption of the trade acceptance method, avoid the necessity of heavy borrowing, and the tying up of their capital and borrowed money in open accounts, and, as their operating expenses are reduced, their profits are accordingly increased. Moreover, the merchant can estimate with a considerable degree of certainty what his income will be from month to month, for, with its fixed date of maturity, payment of a trade ac-

ceptance can usually be counted upon. A merchant receiving trade acceptances may discount them at his bank and thus obtain the immediate use of funds required for his business.

The practical effect of the ordinary book account is to burden the seller with the financing of the customer's business. This not only ties up the capital of the seller, thus narrowing the scope of his business, but also weakens his financial statement because of the character of his accounts. By demanding trade acceptances, the seller is able to overcome these difficulties, since eligible acceptances are considered an excellent investment for banks, and may be readily negotiated.

Advantages to the Banker

From the standpoint of a banker, the trade acceptance is a very advisable form of investment, since it represents sales actually made and offers paper secured by two names instead of by one, as in the case of a promissory note. The trade acceptance offers security upon which the banker can easily borrow

by reason of the fact that eligible trade acceptances may be rediscounted at any Federal reserve bank at favorable rates of interest. Under this system, banks finance the sales of goods, whereas, under the old system, the manufacturer or seller was forced to do this.

The bank, also, is enabled, through the general use of trade acceptances, to ascertain more readily the credit of its customers as well as their business methods.

Bank Acceptances

Trade and Bankers' Acceptances Distinguished

Some confusion has arisen as to the difference between trade acceptances and bankers' acceptances. The former is the result of a transaction between the buyer and seller; the latter the result of the granting of credit by a banker. In the former case, it is the buyer who accepts the draft; in the latter it is the bank.

Definition

A banker's acceptance is defined by the Federal Reserve Board as "a draft or bill of

exchange, whether payable in the United States or abroad and whether payable in dollars or some other money, of which the acceptor is a bank or trust company, or a firm, person, company, or corporation engaged generally in the business of granting bankers' acceptance credits."

How Acceptance Credit is Extended

In other words, a bank acceptance consists of the extension of the bank's credit to a customer, wherein the bank, for a consideration, permits the customer to use its credit. This credit may be either secured or unsecured, depending upon the business, character and financial responsibility of the applicant.

Distinction Between a Bank's Acceptance and its Note

According to an opinion of the counsel of the Federal Reserve Board, when a member bank of the Federal Reserve System accepts a draft or bill of exchange drawn against it, it enters into a contract substantially similar to that of the maker of a note, so that while the form of the instrument differs, the legal

effect is the same. The use of a bank's acceptance, however, differs from the use of its promissory note. When a bank accepts a draft or bill of exchange for one of its customers, it merely lends its credit responsibility to its customer in order that he may procure the funds elsewhere. The holder of a bank's acceptance has the same legal rights against the bank as the holder of its promissory note.

Method of Using

A bank acceptance may be created as follows:

Richard Brown, in New York, buys of John Doe, in Galveston, a quantity of merchandise. In order to reimburse John Doe in a convenient manner, Brown arranges with his bank in New York to accept, on presentation, the drafts of John Doe with documents attached. Doe thereupon, under the terms of the sale, draws on the bank, which accepts the drafts, taking possession of the documents. The drafts drawn by Doe on the bank after they have been accepted become bank acceptances. Then ensues a credit

operation between the bank and Richard Brown to determine what disposition is to be made of the documents and upon what terms the bank will surrender them. This adjustment is easily made. The bank having agreed to pay the acceptances when they fall due, Brown undertakes to provide the bank with funds for that purpose prior to the maturity of the acceptance. (It must be borne in mind that the bank is primarily liable upon its acceptance, and that the security for its acceptance is the merchandise, which is the basis for the transaction. The bank also has the guarantee of the purchaser of the merchandise.)

Commercial Credit Bills

The foregoing case describes a documentary bill. Another form of acceptance is created when the customer draws his own draft directly on the bank, and the bank accepts it for payment at a future time. Such an acceptance would be called a commercial credit bill and might be secured by warehouse receipts or other collateral, or simply by the general credit of the customer.

JOHN DOE

\$1000.00

Ninety

Salvatore June 19 1918

days after sight

At time of acceptance this bill was accompanied by shipping documents and other documents in support of the bill which was drawn by GUARANTY TRUST COMPANY OF NEW YORK

For value received and charge to account of

To Guaranty Trust Co. of N.Y.

140 Broadway

No. 2000 New York City

John Doe

Bank Acceptance

Advantages of the Bank Acceptance

Bank acceptances offer certain distinct advantages not only to merchants but also to the banks through which they deal. The specific advantages may be summarized as follows:

The use of acceptances makes it possible for trust companies and banks to finance legitimate business transactions of their customers properly and conveniently.

Banks having surplus money which cannot readily be employed at the time may invest it in prime acceptances which may either be held until maturity or sold in the open market, should such action be necessary.

Because of their ready marketability, acceptances of well-known institutions will be sought more and more as short-term investments and will be especially valuable as such.

Advantages in Foreign Trade

At this time, when we are striving to further develop our foreign trade, the advantages of the acceptance in foreign transactions are worthy of especial consideration.

Those who have desired to engage in foreign trade have experienced much difficulty in their inability to grant as good terms of credit as have been accorded foreign buyers by competitors abroad. It has been the practice of many American exporters to require payment in cash at New York against documents, and the foreign trade of this country has thus been handicapped. This difficulty may be overcome by the use of bank acceptances, as the credit required for the goods may be established by drawing at sixty or ninety days' sight on a New York accepting bank or trust company, the acceptance being discounted at the current rate, or at an agreed fixed rate.

Another advantage to the exporter is that he is immediately reimbursed for the value of his products or merchandise and, instead of having his capital tied up in credits, it is released for re-employment in new business.

Acceptances based principally on the commodities exported form a valuable security. This was particularly evidenced in London at the outbreak of the war, when acceptances amounting to more than £500,000,000 were in circulation. The greater part of these were

subsequently liquidated by the "self-liquidating" process; that is, by the sale of the commodity which formed the basis of the transaction, thus proving the soundness of the accepting business in general.

High Class of Security

The standing and credit of the accepting bank make the paper it accepts a security of the highest class. The bank acceptance at once eliminates the necessity and trouble of closely investigating the drawer or the indorsers, as the primary responsibility rests with the accepting bank. If its credit is good, all other names on the paper may be of secondary importance.

Field of Buyer Broadened

Bank acceptances enhance the credit and broaden the buying field of the merchant. By means of a letter of credit from his bank to the effect that, under certain conditions and up to a certain agreed figure, it will accept all bills drawn for his account, the merchant is able to make his purchases advantageously, even in markets where he is unknown.

Broadening Market for Acceptances

The Sixth Annual Report of the Federal Reserve Board covering operations for the year 1919 says:

"The demand for bankers' acceptance credit continues to increase substantially and more bills are being created than ever before. Freer shipping facilities have promoted larger import movements, particularly from South America and the Orient, and increased commodity prices have resulted in very large dollar drawings from those markets. The increased price of cotton this year also has required much greater banking accommodation, which has largely taken bankers' acceptance form, with the result that many new names have appeared in the New York market as acceptors, principally of banks located in the South and Southwest.

"The further development during the year of the business of accepting corporations and foreign trade banks has been rapid. At the end of the year such institutions located in New York had aggregate capital and surplus in excess of \$38,802,000, and their liability for acceptances outstanding was approximately \$90,000,000.

"While discount houses and dealers in bills have endeavored strenuously to accomplish distribution of this increased volume of bills and in the main have been fairly successful, the almost constant advance in money rates made their task increasingly difficult. Not only have they had to carry larger portfolios, often requiring

for that purpose funds obtainable only at rates equal to or higher than those earned by their portfolios, but the higher rates for call money on investment securities attracted to that market out-of-town funds that would otherwise have been at the service of commercial requirements; and during the latter months of the year, as the market rates for bills yielded along with other rates to higher levels, there developed an instability that prevented satisfactory distribution. Under these circumstances the Federal Reserve Banks absorbed an increasing amount of bills in the open market, buying from member banks and dealers alike at uniform rates for prime indorsed paper."

* * * * *

"There has been during the year a continuous increase in the amount of open-market purchases of acceptances made chiefly by the Federal Reserve Banks located in New York and Boston, which cities are the principal acceptance markets.

"The Federal Reserve Banks of Cleveland, Chicago, Minneapolis, Kansas City, and San Francisco have participated daily in the open-market purchases of the Federal Reserve Bank of New York under an agreement approved by the Federal Reserve Board. Other Federal Reserve Banks have undertaken to care for acceptances originating in their own districts which have been sold in the New York market. The total purchases of acceptances by the Federal Reserve Bank of New York amounted to \$1,950,898,000, * * * .

"In order to maintain an open market for bankers'

acceptances the Federal Reserve Banks of Boston and New York have been called upon constantly to make very heavy purchases, and it has been necessary for these banks in order to sustain their reserves to make large sales of acceptances. Other Federal Reserve Banks have had, from time to time, surplus funds and with the approval of the Federal Reserve Board have purchased bankers' acceptances from these eastern banks. In cases where Federal Reserve Banks have of their own initiative purchased bankers' acceptances from other Federal Reserve Banks with the approval of the Board, the indorsement of the selling bank has not been given as a rule, but whenever the Board has requested a Federal Reserve Bank to rediscount bankers' acceptances for another the selling bank has been required to indorse the bills sold.

"The Federal Reserve Banks of Cleveland, Chicago, St. Louis, Minneapolis, and San Francisco are the only banks which have neither rediscounted nor sold paper during the past year. Rediscount operations between Federal Reserve Banks including straight purchases of bankers' acceptances during the year have amounted to \$2,658,254,000, as compared with \$660,638,000 during the year 1918. In addition to these transactions the Federal Reserve Bank of New York has purchased and allotted to other Federal Reserve Banks \$730,866,000 of bankers' acceptances, making a total inter-district movement of bills discounted and acceptances purchased and allotted to other Federal Reserve Banks of \$3,389,120,000."

The tabular statement shown on page 32, of acceptances bought by Federal reserve banks during the past five years shows the enormous increase in the volume of the acceptance business.

Discount Rates on Trade and Bankers' Acceptances

Bankers' acceptances are regarded by the Federal Reserve Board as the most liquid of all investments, and consequently it has usually permitted a substantial differential in their favor, though, of course, the rates of discount are subject to fluctuations reflecting accurately the varying conditions of the money market. A preferential rate in favor of trade acceptances, also, was allowed by Federal reserve banks until the latter part of 1919. This showed the official indorsement of the acceptance system of credit. Late in 1919, however, an advance in discount rates was authorized by the Board which eliminated the differential, at least, so far as the trade acceptance was concerned, and again in 1920 further increases in rates were allowed because of conditions in this country.

ACCEPTANCES BOUGHT BY FEDERAL RESERVE BANKS.*

FEDERAL RESERVE BANK	BOUGHT IN OPEN MARKET					BOUGHT FROM OTHER FEDERAL RESERVE BANKS		
	1915	1916	1917	1918	1919	1917	1918	1919
Boston.....	14,105,000	52,377,000	86,481,000	194,158,000	380,784,000	5,047,000	6,709,000	.....
New York.....	25,834,000	123,406,000	445,307,000	945,498,000	1,211,399,000	19,659,000	50,182,000	15,827,000
Philadelphia..	7,565,000	53,122,000	70,710,000	77,686,000	14,049,000	15,204,000	42,321,000	.....
Cleveland.....	2,963,000	27,542,000	51,007,000	122,800,000	261,750,000	40,102,000	54,199,000	.....
Richmond.....	250,000	11,313,000	54,759,000	70,766,000	52,977,000	3,357,000	331,000	55,300,000
Atlanta.....	72,000	12,544,000	25,388,000	45,477,000	51,661,000	1,005,000	2,514,000	5,080,000
Chicago.....	5,782,000	27,061,000	61,142,000	122,787,000	292,012,000	5,572,000	100,077,000	5,065,000
St. Louis.....	1,801,000	20,681,000	22,788,000	26,096,000	87,503,000	6,944,000	4,551,000	95,477,000
Minneapolis..	1,455,000	13,539,000	16,397,000	13,903,000	108,714,000	16,675,000	25,911,000	40,320,000
Kansas City	1,788,000	8,191,000	17,561,000	14,691,000	26,086,000	9,264,000	19,047,000	19,282,000
Dallas.....	.....	3,543,000	9,743,000	25,024,000	12,415,000	25,333,000	8,242,000	45,099,000
San Francisco.	3,230,000	32,776,000	48,018,000	150,653,000	345,827,000	20,249,000	22,506,000	10,077,000
TOTAL.....	64,845,000	386,095,000	909,301,000	1,809,539,000	2,825,177,000	168,411,000	336,590,000	133,050,000
								424,577,000

*Taken from Annual Report of the Federal Reserve Board for 1919.

Under the terms of the Phelan Act of April 13, 1920, provision was made for the application of graduated rates of rediscount, rising from a base rate to be established at the option of the board of directors of a Federal reserve bank, according as the applications for rediscount filed by member banks exceeded a specified or base line to which the normal or basic discount rate was applicable. Since the adoption of the Phelan Act the new plan has been put into effect by four Federal reserve banks.

Acceptances Under the Federal Reserve Act*

The Federal Reserve Board has unqualifiedly designated trade acceptances as a favored form of commercial paper, and they are eligible for discount or purchase by Federal reserve banks when they conform to the requirements of the Federal Reserve Act and to the regulations of the Federal Reserve Board. In order, therefore, that much of the misun-

*Statements contained under this heading are based on the Federal Reserve Act, regulations of the Federal Reserve Board, and opinions of Counsel of the Federal Reserve Board.

derstanding and uncertainty which has tended to discredit the merit and use of such paper may be avoided, the trade acceptance should comply with the rules and regulations of the Federal Reserve Board.

Defined by Federal Reserve Board

The Federal Reserve Board has defined the trade acceptance as "a draft or bill of exchange drawn by the seller on the purchaser of goods sold, and accepted by such purchaser." The word "goods" as here used, means goods, wares, merchandise, or agricultural products, including live stock. The purchase price of goods plus the cost of labor in effecting their installation may be included in the amount for which the trade acceptance is drawn. A consignment of goods or a conditional sale of goods cannot be considered "goods sold" within the meaning of the definition of a trade acceptance, and an acceptance which provides that the drawer is to retain title to the goods until payment of the acceptance is not consistent with the requirement of a legitimate trade acceptance that the title shall have passed to the drawee at the

time of acceptance. The actual sale of goods and not what is generally termed a conditional sale must be the basis of the acceptance.

A draft or bill of exchange is defined by the Federal Reserve Board as "an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay in the United States, at a fixed or determinable future time, a sum certain in dollars to the order of a specified person."

Qualifications Essential to Negotiability

To be negotiable, a bill of exchange must be an unconditional order to pay on demand, or at a fixed or determinable future time, a certain sum of money to order or to bearer, and if payment is made dependent upon a condition or contingency, the bill becomes conditional and non-negotiable.

A general acceptance of a conditional bill does not make it negotiable and a conditional acceptance of an unconditional bill destroys its negotiability, because the acceptance is thereby made a conditional one. A qualified

or conditional acceptance of a bill of exchange releases the drawer and prior indorsers. A bill drawn payable "at sight" and accepted payable in three months, has been held to be a conditional acceptance. Likewise, an acceptance to pay at a designated place different from the residence of the acceptor, when the bill stipulates that it is to be paid there and not elsewhere, qualifies the terms of the bill and renders the acceptance conditional.

The drawer, if he receives notice of a qualified acceptance, should express his dissent within a reasonable time thereafter, otherwise he will be deemed to have assented thereto.

Reference to Particular Consignment

If payment is confined to the proceeds of a particular fund, and is not chargeable to the general credit of the drawer, the bill is conditional and non-negotiable.

Whether reference to a particular consignment of goods renders the bill conditional has been a source of conflict in the courts, some holding that it is a mere indication of a fund out of which the drawer is to reimburse him-

self, others holding that the bill is thereby made conditional because limiting payment to proceeds of the particular shipment mentioned. A reference, however, in general terms on the face of the accepted bill to the fact that it is based on exportation or importation of goods does not make it conditional and impair its negotiability.

Bills made payable "in exchange" are not payable "in money," and are therefore not negotiable. A provision in a bill that it is payable with interest at a designated rate per annum after maturity if payment is delayed, does not impair the instrument's negotiability. Likewise, by waiving demand, notice, and protest or waiving homestead exemption rights, the negotiability of the bill is not affected.

Discharge of Drawer and Indorsers

The acceptor is the principal debtor after acceptance. Notice of demand and protest must be given to parties secondarily liable in the event of dishonor, but the right to notice is personal and can be waived by drawer and indorsers, the waiver having no effect on the acceptor or principal debtor.

The drawer and indorsers of an instrument made payable at the time specified in the bill are not released by failure to present for acceptance, unless the bill expressly provides that it must be presented for that purpose, or unless it is made payable elsewhere than at the place of business or residence of the drawee.

Acceptances by Member Banks

Under the provisions of Section 13 of the Federal Reserve Act, as amended, member banks are permitted to accept drafts or bills of exchange drawn upon them which, excluding days of grace, have not more than six months' sight to run, if one of the following conditions is present. The bill must

1. Have origin in a transaction involving the importation or exportation of goods, or
2. Arise from a transaction involving domestic shipment of goods and have shipping documents attached at the time of acceptance securing or conveying title to the goods, or
3. Be secured at the time of acceptance by warehouse receipt or other such document conveying or securing title to readily marketable staples.*

*See page 72.

Bills of the classes above designated may be accepted by member banks up to fifty per centum of their capital and surplus, or, where permission is obtained from the Federal Reserve Board, up to one hundred per centum.

The aggregate amount of acceptances growing out of domestic transactions may not exceed fifty per centum of the capital and surplus of any member bank. This condition which is attached to membership in the Federal Reserve System relates to drafts or bills drawn against a state member bank in domestic transactions and accepted by the latter, but not to drafts drawn by an individual against another drawee, accepted by the drawee and discounted by a state member bank.

A member bank is prohibited, also, from accepting for any one person, firm, company, or corporation, whether in a foreign or domestic transaction, drafts or bills of exchange aggregating at any one time more than ten per centum of the capital and surplus of the member bank. The latter limitation has no application where the accepting bank remains

secured either by attached documents or other actual security arising from the transaction covered by the acceptance. A bill of lading draft is actual security even after the documents have been released, provided the draft is accepted by the drawee upon or before the surrender of the documents.

If the aggregate amount of drafts accepted for one person, firm, company, or corporation exceeds ten per centum of the capital and surplus of the accepting bank, such drafts must remain secured throughout their lifetime and the security cannot be released unless other actual security growing out of the same transaction as the acceptance is substituted therefor. The accepting bank may, however, release the security where the total amount accepted for any one customer does not exceed ten per centum of its capital and surplus.

Acceptances Up to One Hundred Per Centum

The Federal Reserve Board has provided that any member bank with an unimpaired surplus equalling at least twenty per centum of its paid-up capital, desiring to accept up

to one hundred per centum of its paid-up and unimpaired capital stock and surplus, may file an application with the Board through the Federal reserve bank of its district. The Federal reserve bank then reports the financial status of the applying bank to the Board and states whether the business and banking conditions in the district are such as to make the granting of the application advisable, whereupon the application is approved or rejected. Any approved application may be rescinded by giving ninety days' notice to the member bank.

Dollar Exchange

Bills drawn on member banks by banks and bankers in foreign countries or dependencies or insular possessions of the United States to furnish dollar exchange, where the usages of trade therein make it necessary, may be accepted by the former to an amount not in excess of fifty per centum of their capital and surplus, provided such drafts have not more than three months' sight to run. This fifty per centum limitation is entirely separate from and not included in the

limits placed by the Act upon the acceptance by a member bank of drafts and bills of exchange drawn against the exportation, importation, or domestic shipment of goods or secured by warehouse receipts covering readily marketable staples.

The ten per centum limitation referred to on page 39 on the acceptance of drafts applies to those drawn to furnish dollar exchange unless accompanied by documents conveying or securing title or by some other adequate security.

In order that a draft drawn by a foreign bank or banker on a member bank for the purpose of furnishing dollar exchange may be accepted by the latter, the drawer must be in a foreign country or dependency or insular possession of the United States where the usages of trade have been determined by the Federal Reserve Board to require the granting of the acceptance facilities applied for. Application must first be made to the Board setting forth the usages of trade in the place where the drawer bank or banker is located. If the Board deems the granting of the application expedient, it will notify the member

bank of its approval which, however, may be revoked upon ninety days' notice to the member bank. The Board has ruled that there is nothing in the provisions of Section 13 of the Federal Reserve Act which can be construed to permit the acceptance by member banks of drafts drawn merely for the purpose of correcting adverse exchange conditions. An application will not be granted, therefore, if it appears that the drafts are to be drawn not because the usages of trade so require but merely because dollar exchange is at a premium in the country in which the drawer is located.

Acceptances Financing Imports or Exports

A member bank may accept drafts drawn for the purpose of importing goods, whether or not the sale under consideration has been consummated at the time of the acceptance, but the accepting bank must be reasonably sure that the draft is drawn to finance a transaction involving importation or exportation of goods, that its proceeds will be used for that purpose and that there is a definite, bona fide contract for shipment within a reason-

able and specified time. If the accepting bank believes that the proceeds will ultimately be used solely for the purpose of financing the transaction involving the importation of goods, it is immaterial whether or not the goods have been actually sold at the time of the acceptance, and it is not even necessary that the goods be identified at that time.

National banks cannot accept drafts for the purpose of enabling domestic concerns to extend credits on open account to foreign purchasers.

Drafts of Persons Doing Both Export and Domestic Business

Where a dealer engaged in the purchase of the same character and class of goods for export and domestic use, desires to finance the purchase and sale of goods to be exported, his agreement with a member bank accepting drafts should show that he has a contract for the exportation of the goods, that the total amount of drafts drawn under such credit will not exceed the aggregate amount involved in the export contract, that the pro-

ceeds of the drafts are to be used in connection with the export transaction, and that the proceeds of the sale of the goods exported will be applied to pay acceptances, unless the dealer has meanwhile provided the bank with funds to meet such acceptances at maturity, or has properly secured them.

Option of Dealers to Secure Drafts

A dealer having drawn drafts accepted by a member bank in an export transaction, should, with the consent of the accepting bank, be given the option to secure such drafts in the manner required of bills drawn in domestic transactions, if he desires to use the proceeds derived from the sale of the goods exported for purposes other than the payment of such drafts.

Guarantee as to Exportation

A member bank cannot accept drafts drawn by an exporter in a foreign country to provide funds for the purchase of farm products from farmers in such country unless the foreign exporter has a contract to ship the commodities in question to some other country. Unless the member bank has a guarantee to

this effect, the transaction is not one involving importation or exportation of goods, and the fact that the foreign exporter intends a sale of the goods in a foreign country is not sufficient. An actual contract of sale must exist and it must appear that the drafts are merely drawn in advance of the actual shipment of goods under the contract of sale.

Miscarriage of Export Transaction

If fully secured, a member bank may accept drafts drawn by a domestic firm, having a contract to sell to foreign buyers, when the transaction is made in good faith, though resulting in the ultimate sale of the goods to an American instead of to a foreign purchaser.

Maturity to Approximate Duration of Shipment

Although the Act fixes a maximum maturity of six months, yet in cases where a draft is drawn against a shipment of goods in a transaction not involving the sale, the maturity of the draft should approximate the duration of the transit of the goods, the law con-

templating that the acceptance should be to finance the shipment and that it should not be the means of furnishing a credit for any other purpose.

Where a draft is drawn against the shipment of goods in a transaction involving their sale, the draft may be drawn and accepted for the purpose of financing not merely the shipment but also the sale of the goods. In this connection, it has been held that a draft drawn against goods shipped from a corporation to its agent may be accepted by a member bank even though no actual sale is involved.

Attached Documents in Domestic Transactions

The provision which authorizes member banks to accept drafts based on domestic shipments of goods when shipping documents are "attached," does not mean that the documents must be physically fastened to the draft. Shipping documents must, however, be made out or indorsed so as to convey or secure title to the accepting bank.

Acceptance of Drafts Secured by Warehouse Receipts

No draft which is secured by a warehouse receipt should properly be considered eligible for acceptance under the terms of Section 13 of the Federal Reserve Act unless the goods covered by the warehouse receipt are being held in storage pending a reasonably immediate sale, shipment, or distribution into the process of manufacture. Any draft, therefore, which is drawn to carry goods for speculative purposes or for an indefinite period of time, without the purpose to sell, ship, or manufacture within a reasonable time, should not be considered eligible for acceptance under the provisions of Section 13. Such a draft would be merely a cloak to evade the restrictions of Section 5200 of the Revised Statutes and is not one of the kinds which Congress intended to make eligible for acceptance.

Surrender of Documents

Where drafts are secured by warehouse receipts it may be necessary at some period during the life of the draft for the receipt to be surrendered to the customer for whom the

acceptance was made, in order that the transaction involved may be consummated, and it is ordinarily necessary to release the shipping documents at an earlier period than in the case of warehouse receipts, but in any event the security should not be surrendered until this becomes necessary. When the documents are surrendered the bank should protect itself by procuring either a trust receipt or a definite agreement on the part of the customer to whom the security is surrendered that the proceeds derived from the sale of the goods represented by the shipping documents or warehouse receipts will be deposited with the accepting bank when available to pay the draft at maturity and will not be used by the customer for other purposes. Where a trust receipt is substituted the ten per centum limitation applies if the receipt is of such a character as to give access to or control over the goods to the customer for whom the draft was accepted, since such a receipt is not regarded as "actual security" within the meaning of Section 13 of the Federal Reserve Act.

It is a sufficient compliance with the terms of the Federal Reserve Act if shipping docu-

ments are in the possession of the accepting bank and it has a lien on the property represented by the documents at the time the bill is accepted. Where placed in the possession of the bank's agent and under the control of the bank, such documents may be considered as in the possession of the bank.

Purchase by Member Bank of Its Own Acceptances

In the past banks were accustomed to buy many of their own acceptances because it was necessary in order to develop the acceptance market. While it is undesirable in the opinion of the Federal Reserve Board for a bank to buy its own acceptances, it is essential that the credit of the accepting bank be protected through such purchase where the market conditions prevent absorption.

Purchase by a bank of its own acceptances is equivalent to a loan or advance to the customer for whom the acceptance is made, and the liability of the customer is subject to the limitations placed on loans. The power of a member bank to accept drafts is entirely

distinct from the power to discount acceptances of others.

Member banks purchasing their own acceptances before maturity need not include them in the aggregate of acceptances authorized by the Federal Reserve Act.

Acceptances by Corporations Formed Under the Edge Act

By virtue of the provisions of Section 25 (a) which was added to the Federal Reserve Act on December 24, 1919, and which is known as the Edge Act, any corporation formed for the purpose of engaging in international or foreign banking or other international or foreign financial operations or for engaging in such operations in a dependency or insular possession of the United States, either directly or through the agency, ownership, or control of local institutions in such places, may accept

- (1) Drafts and bills of exchange drawn upon it which grow out of transactions involving the importation or exportation of goods, and
- (2) Drafts and bills of exchange which are drawn by banks or bankers located in foreign countries or

dependencies or insular possessions of the United States for the purpose of furnishing dollar exchange as required by the usages of trade therein.

Except with the approval of the Federal Reserve Board and subject to such limitations as it may prescribe, no such corporation may

- (a) Exercise its power to accept drafts or bills of exchange if at the time they are presented for acceptances it has outstanding any debentures, bonds, notes, or other such obligations issued by it;
- (b) Accept any draft or bill of exchange which grows out of a transaction involving the importation or exportation of goods with a maturity in excess of six months;
- (c) Accept any draft or bill of exchange drawn for the purpose of furnishing dollar exchange with a maturity in excess of three months.

Limitations on Acceptances

No acceptances may be made for the account of any one drawer in an amount aggregating at any time in excess of ten per centum of the subscribed capital and surplus of the accepting corporation, unless the transaction is fully secured or represents an exportation or importation of commodities and is guar-

anteed by a bank or banker of undoubted solvency.

Whenever the aggregate of acceptances outstanding at any time

- (a) exceeds the amount of the subscribed capital and surplus, fifty per centum of all the acceptances in excess of the amount must be fully secured; or
- (b) exceeds twice the amount of the subscribed capital and surplus, all the acceptances outstanding in excess of such amount must be fully secured.

The corporation may elect whichever requirement (a) or (b) calls for the smaller amount of secured acceptances. In no event may any such corporation have outstanding at any one time acceptances drawn for the purpose of furnishing dollar exchange in an amount aggregating more than fifty per centum of its subscribed capital and surplus.

Reserves Required

Reserves against acceptances must be in liquid assets of any or all of the following kinds: (1) cash; (2) balances with other banks; (3) bankers' acceptances; and (4) such securities as the Federal Reserve Board may from time to time permit.

A reserve of at least fifteen per centum must be maintained against all acceptances outstanding which mature in thirty days or less and a reserve of at least three per centum against all acceptances outstanding which mature in more than thirty days.

Liabilities of One Borrower

The total liabilities to any corporation established under the Edge Act of any person, company, firm, or corporation for money borrowed, including in the liabilities of a company or firm, the liabilities of the several members thereof, may at no time exceed ten per centum of the amount of its subscribed capital and surplus, except with the approval of the Federal Reserve Board. The discount, however, of bills of exchange drawn in good faith against actually existing values and the discount of commercial or business paper actually owned by the person negotiating the same is not to be considered as money borrowed within the meaning of this provision. The liability of a customer on account of an acceptance made by such a corporation for his account is not a liability for money bor-

rowed within the meaning of this provision unless and until he fails to place the corporation in funds to cover the payment of the acceptance at maturity or unless the corporation itself holds the acceptance.

Aggregate Liabilities of a Corporation

The aggregate of any such corporation's liabilities outstanding on account of acceptances, average domestic and foreign deposits, debentures, bonds, notes, guaranties, indorsements and other such obligations may not exceed at any one time ten times the amount of the corporation's subscribed capital and surplus, except with the approval of the Federal Reserve Board. In determining the amount of the liabilities within the meaning of this provision, indorsements of bills of exchange having not more than six months to run, drawn and accepted by others than the corporation, are not to be included.

Eligibility

A bill or acceptance is said to be "eligible" when it may be purchased or discounted by a Federal reserve bank. In order to be

eligible, it must conform to all the requirements of the Federal Reserve Board, since otherwise it cannot be purchased or discounted by Federal reserve banks and will thereby lose one of its greatest assets.

Discount by Federal Reserve Bank

A Federal reserve bank may discount for any of its member banks any note, draft, or bill of exchange, provided it has the following requisites:

1. It must have a maturity at the time of discount of not more than ninety days, excluding days of grace, but where drawn for agricultural purposes* or based on live stock it may have a maturity of not more than six months.
2. It must have arisen out of actual commercial transactions, namely, it must be an instrument drawn for agricultural, industrial, or commercial purposes, or the proceeds of which have been or are to be used for such purposes.
3. It must not have been issued to carry or trade in stocks, bonds, or other investment securities, except bonds and notes of the United States.
4. The aggregate of notes, drafts, and bills bearing the signature or indorsement of any one borrower,

*See definition of "Agricultural Paper" on page 64.

whether person, firm, company or corporation, rediscounted for any one member bank, whether state or national, must not exceed at any time, ten per centum† of the unimpaired capital and surplus of such bank, this restriction, however, not applying to the discount of bills of exchange drawn in good faith against actually existing values.

5. It must be indorsed by a member bank.
6. It must conform to the regulations of the Federal Reserve Board.

No Federal reserve bank may discount for any member state bank or trust company any of the notes, drafts, or bills of any one borrower who is liable for borrowed money to such state bank or trust company in an amount greater than ten per centum‡ of the

†Under the terms of Section 11(m) as amended by the Act of March 3, 1919, a Federal reserve bank may, until December 31, 1920, rediscount for any member bank, whether state or national, notes, drafts, and bills bearing the signature or indorsement of any one borrower in an amount not to exceed twenty per centum of the member bank's capital and surplus, provided that the excess over and above ten per centum be secured by not less than a like face amount of bonds or notes of the United States issued since April 24, 1917, or certificates of indebtedness of the United States.

‡Under the terms of Section 11 (m) as amended by the Act of March 3, 1919, a Federal reserve bank may, until December 31, 1920, rediscount for a member state bank or trust company paper of any one borrower secured by not less than a like face amount of bonds or notes of the United States issued since April 24, 1917, or certificates of indebtedness of the United States, even though such state bank or trust company may already have loaned to the borrower under his regular line of credit in excess of the ten per centum limit defined above. If, however, the member state bank or trust company has loaned to one borrower in excess of that ten per centum limit under his regular line of credit the Federal reserve bank can not rediscount for that state bank or trust company any of the paper of that borrower taken under that regular line of credit, but may rediscount any paper so secured by Government obligations of the kinds specified up to an amount not in excess of twenty per centum of the capital and surplus of such state bank or trust company.

capital and surplus of that state bank or trust company, but in determining the amount of money borrowed from the state bank or trust company, the discount of bills of exchange drawn in good faith against actually existing value and the discount of commercial or business paper actually owned by the person negotiating the same is not to be included. In the opinion of the Board, however, accepted demand bills on which the drawer is released from liability are not "bills of exchange" within the meaning of Section 13 and must, therefore, be included in determining the limits on the amount of paper of any one borrower which a Federal reserve bank may rediscount for any member bank.

General Character of Eligible Instruments

The Federal Reserve Board has determined that the instrument itself to be eligible for rediscount at a Federal reserve bank must meet the following requirements:

1. It must be an instrument which has been issued or drawn, or the proceeds of which have been used or are to be used in the first instance, in producing, pur-

chasing, carrying, or marketing goods in one or more of the steps of the process of production, manufacture, or distribution, or for the purpose of carrying or trading in bonds or notes of the United States.

2. Its proceeds must not have been used nor contemplate use for permanent or fixed investments of any kind, such as lands, buildings, machinery, or for any other capital purpose.
3. Its proceeds must not have been used nor contemplate use for investments of a purely speculative character or for the purpose of lending to some other borrower.
4. It may be secured, if it is otherwise eligible, by the pledge of goods or collateral of any nature, including paper, which is ineligible for rediscount.

Applications for Rediscount

A member bank must make application for rediscount to the Federal reserve bank. A member bank must furnish with all applications for the rediscount of notes, drafts or bills of exchange, its certificate to the effect that, to the best of its knowledge and belief, the instrument has been issued or drawn, or its proceeds have been used or are to be used in the first instance, in producing, purchasing, carrying or marketing goods in one or more

of the steps of the process of production, manufacture, or distribution, or for the purpose of carrying or trading in bonds or notes of the United States. In the case of a member state bank or trust company, all applications must contain a certificate or guaranty to the effect that the borrower is not liable and will not be permitted to become liable during the time his paper is held by the Federal reserve bank, to such bank or trust company for borrowed money in an amount greater than ten per centum of the capital and surplus of the state bank or trust company.

Evidence of Eligibility

A Federal reserve bank must take whatever steps it deems necessary to satisfy itself as to the eligibility of the draft, bill, or trade acceptance offered for rediscount and may require a recent financial statement of one or more parties to the instrument. The instrument should be drawn so as to evidence the character of the underlying transaction, but if it is not so drawn evidence of eligibility may consist of a stamp or certificate affixed by the

acceptor or drawer in a form satisfactory to the Federal reserve bank.

Syndicate Paper

Where syndicates are formed for the purpose of granting acceptance credits for more than moderate amounts, Federal reserve banks should be consulted with regard to the transaction and will then decide the question of eligibility, both as to the character and amount of the bill, subject to the approval of the Federal Reserve Board.

Use for Commercial or Industrial Purposes

Where the proceeds of paper have been or are to be used to purchase coal or to provide funds for payment of other expenses of operation, if the paper is otherwise in conformity with the law, and the regulations of the Board, it is eligible for rediscount at Federal reserve banks. If doubt exists whether the proceeds are to be used for commercial or industrial purposes or whether for permanent or fixed investments, then the Federal reserve bank may accept a statement of the borrower showing a reasonable excess

of quick assets over current liabilities to evidence the fact that it is not drawn to make a fixed investment.

Bills Drawn Against Actually Existing Values

A bill of exchange discounted before acceptance may be said to be drawn against actually existing value only when accompanied by shipping documents, or warehouse receipts, or other papers securing title to the goods sold. An accepted bill of exchange, unaccompanied by shipping documents or other such papers may be considered as drawn against actually existing value if drawn against the drawee at the time of, or within a reasonable time after the shipment or delivery of the goods. In the latter case, there must be reasonable grounds for belief that the goods are actually in existence in the hands of the drawee in their original form, or in the shape of the proceeds of their sale.

Bills drawn by the seller against the purchaser and accepted before the sale or delivery of the goods should not be treated as bills drawn against actually existing values,

since such goods are not in the possession of the drawee either in their original form or in the shape of the proceeds of their sale, but where the goods have passed out of the possession of the drawer and have been placed in storage subject to the control or order of the drawee a different situation would be presented.

If a trade acceptance is drawn at the time of or within a reasonable time after the sale and delivery of the goods, when there is reason to believe that the goods are in the possession of the purchaser, either in their original form or in the shape of the proceeds of the sale, it may be treated as a bill of exchange drawn against actually existing value. If, however, a bill is drawn for the purchase price of goods sold, in order to convert a balance carried on open account into a negotiable instrument, such a bill, when accepted, might comply with the Board's definition of a trade acceptance, but could not be treated as a bill of exchange drawn against existing value, unless drawn within a reasonable time after the sale and delivery of the goods.

Agricultural Paper

Six months' agricultural paper has been declared eligible for rediscount at a Federal reserve bank if it conforms to the regulations which would apply if its maturity were ninety days or less, instead of six months. The term "six months' agricultural paper" has reference to a note, draft, bill of exchange, or trade acceptance drawn or issued for agricultural purposes, or based on live stock. It is an instrument whose proceeds have been used or contemplate use for agricultural purposes, including the breeding, raising, fattening, or marketing of live stock, and which has a maturity at the time of discount of not more than six months, exclusive of days of grace.

Paper Covering Sale of Agricultural Implements

The Federal Reserve Board holds that the six months' maturity privilege does not apply to sales by a manufacturer of agricultural implements to a dealer for resale by him to a farmer since such paper must be treated as

commercial and not as agricultural paper. It therefore cannot be rediscounted with a Federal reserve bank if it has a maturity of more than ninety days.

Discount of Bankers' Acceptances

A Federal reserve bank may rediscount any banker's acceptance having a maturity at the time of discount of not more than three months, exclusive of days of grace, which has been drawn under a credit opened for the purpose of conducting or settling accounts resulting from a transaction or transactions involving any one of the following:

1. The shipment of goods between the United States and a foreign country, or between the United States and any of its dependencies or insular possessions, or between foreign countries, or
2. The shipment of goods within the United States, provided shipping documents conveying security title are attached at the time of acceptance, or
3. The storage of readily marketable staples, provided the bill is secured at the time of acceptance by warehouse, terminal, or other similar receipt, conveying security title to such staples, issued by a party independent of the customer, and provided the acceptor remains secured throughout the life of the acceptance.

A Federal reserve bank may also rediscount any bill drawn by a bank or banker in a foreign country, or dependency or insular possession of the United States for the purpose of furnishing dollar exchange, in accordance with the regulations relating to acceptances by member banks, provided the bill has a maturity at the time of discount of not more than three months, exclusive of days of grace.

Evidence as to Eligibility

Federal reserve banks must be satisfied from the acceptance itself, or otherwise, that it is eligible for rediscount. The bill itself should be drawn so as to evidence the character of the underlying transaction, but if it is not so drawn evidence of eligibility may consist of a stamp or certificate affixed by the acceptor in a form satisfactory to the Federal reserve bank.*

Transactions Involving Shipments of Goods in Foreign Trade

It is not necessary that shipping documents covering goods in the process of shipment be

*In either case the bill itself or the acceptor's certificate must state (a) nature of merchandise, (b) point of shipment, (c) place of destination; or in the case of a warehouse credit, the nature of the staple and the place of storage.

It is desirable that the above mentioned particulars be noted on the bill by the drawer before presentation for acceptance. This would obviate the necessity of a certificate by the accepting bank.

attached to drafts drawn for the purpose of financing the exportation or importation of goods, and it is not essential, therefore, that each such draft cover specific goods actually in existence at the time of acceptance, but it is essential as a prerequisite to eligibility either that shipping documents or a documentary export draft be attached at the time the draft is presented for acceptance. If the goods covered by the credit have not been actually shipped, there must be in existence a specific and bona fide contract providing for the exportation or importation of such goods at or within a specified and reasonable time and the customer must agree that the accepting bank will be furnished in due course with shipping documents covering such goods or with exchange arising out of the transaction being financed by the credit. A contract between principal and agent will not be considered a bona fide contract of the kind above required, nor is it enough that there be a contract providing merely that the proceeds of the acceptance will be used only to finance the purchase or shipment of goods to be exported or imported.

Where a transaction against which a draft is drawn, involves a direct sale to a foreign purchaser, the fact that it may be consummated before the exportation actually commences is immaterial, if the transaction is bona fide and the accepting bank has no reason to believe that the purchaser will divert the goods from their foreign destination.

Storage of Readily Marketable Staples

Where a bill has been drawn under a credit opened for the purpose of conducting or settling accounts resulting from a transaction or transactions involving the storage of readily marketable staples, and the goods must be withdrawn from storage prior to the maturity of the acceptance or the retirement of the credit, a trust receipt or other similar document covering the goods may be substituted in lieu of the original document, provided such substitution is conditioned upon a reasonably prompt liquidation of the credit. In order to insure compliance with this condition, it should be required, when the original document is released, either that the proceeds of the goods will be applied within a

specified time toward a liquidation of the acceptance credit or that a new document, similar to the original one, will be resubstituted within a specified time.

Acceptances in Excess of Ten Per Centum

In order to be eligible, acceptances for any one customer in excess of ten per centum of the capital and surplus of the accepting bank must remain actually secured throughout the life of the acceptance. In the case of acceptances of member banks this security must consist of shipping documents, warehouse receipts or other such documents, or some other actual security growing out of the same transaction as the acceptance, such as documentary drafts, trade acceptances, terminal receipts, or trust receipts which cover goods of such a character as to insure at all times a continuance of an effective and lawful lien in favor of the accepting bank. Other trust receipts are not secured within the meaning of this requirement if they permit the customer to have access to or control over the goods.

Maturity of Acceptance

Although a Federal reserve bank may legally rediscount an acceptance having a maturity at the time of discount of not more than three months, exclusive of days of grace, it may decline to rediscount any acceptance the maturity of which is in excess of the usual or customary period of credit required to finance the underlying transaction or which is in excess of that period reasonably necessary to finance such transaction. Since the purpose of permitting the acceptance of drafts secured by warehouse receipts or other such documents is to permit of the temporary holding of readily marketable staples in storage pending a reasonably prompt sale, shipment, or distribution, no such acceptance should have a maturity in excess of the time ordinarily necessary to effect a reasonably prompt sale, shipment, or distribution into the process of manufacture or consumption.

Acceptance Pledged as Collateral Security

Where an acceptance house purchases an acceptance based on the importation or exportation of goods and desires to reimburse

itself by drawing a bill upon a national bank, the acceptance, which was based upon the transaction involving the importation or exportation of goods, being pledged as collateral security for the bill, the new bill cannot be said to grow out of the original export transaction in the sense contemplated in the Federal Reserve Act. Hence, a national bank cannot accept a draft drawn under these circumstances, since it is not an acceptance growing out of a transaction involving the importation or exportation of goods, and because it is not an acceptance of that class authorized by the amendment of September 7, 1916. It is not drawn by a bank or banker located in a foreign country and does not grow out of a transaction involving the domestic shipment or storage of goods.

Readily Marketable Staples

If a new transaction is entered into after importation has been completed, it would constitute a domestic transaction, in which case it must be decided whether or not the goods are to be considered "readily marketable." If they are, the acceptor must be

secured by warehouse receipts or other documents. A readily marketable staple is defined as "an article of commerce, agriculture or industry of such uses as to make it the subject of constant dealings in ready markets with such frequent quotations of price as to make (a) the price easily and definitely ascertainable and (b) the staple itself easy to realize upon by sale at any time." The Federal Reserve Board suggests that although the law does not expressly restrict eligible staples to those which are nonperishable, nevertheless, banks as a matter of prudence and protection to themselves should not consider as eligible any staple which in its nature is so perishable as not to be reasonably sure of maintaining its value as security at least for the life of the draft which is drawn against it.

Drafts Secured by Chattel Mortgages

The Federal Reserve Board has ruled that drafts or bills of exchange drawn in domestic transactions against a national bank cannot be accepted when secured by a chattel mortgage on cattle, but only when accompanied by shipping documents or when secured by a

warehouse receipt or other similar documents conveying or securing title to readily marketable staples. While cattle may be treated as readily marketable staples, a chattel mortgage is not regarded as a document similar to a warehouse receipt since the borrower retains the possession of the goods and conveys to the bank only the legal title. The Federal Reserve Board, having concluded that national banks and member banks are not authorized to accept bills secured by chattel mortgages on cattle, has deemed it advisable that Federal reserve banks should consider as ineligible bills drawn against the security of such chattel mortgages, whether accepted by member or non-member banks.

Discount of Renewals

In connection with the discount of renewal acceptances, the Sixth Annual Report of the Federal Reserve Board says:

"Under the law the Board appears to have some latitude of discretion in the matter of permitting Federal Reserve Banks to discount renewal acceptances, and this authority was granted in a few instances and for comparatively small amounts during the war and im-

mediately following the cessation of hostilities. The Board had repeated applications during the first half of the year for authority to discount renewal acceptances growing out of various foreign transactions, but has consistently declined to admit the eligibility of renewals except in cases where owing to delay in transportation or for other reasons it was clear that the renewal bill would meet all requirements applicable to the original acceptance, and that the goods covered by the acceptances were still in existence unconverted in form and capable of ready identification."

While a national bank may properly enter into an agreement having more than six months to run by which it obligates itself to accept drafts of the kinds made eligible for acceptance by member banks, each individual draft accepted under the terms of that agreement must, in order to be eligible, conform in all respects to the provisions of the law and regulations of the Federal Reserve Board. Inasmuch as each individual acceptance must itself conform to the terms of the law, no renewal draft, whether or not contracted for in advance, can be eligible if at the time of its acceptance the period required for the conclusion of the transaction out of which the original draft was drawn shall have elapsed. The

question of the eligibility of renewal drafts, therefore, must necessarily depend upon the stage of the transaction at the time the renewal drafts are drawn.

Purchase of Acceptances by Federal Reserve Banks

Federal reserve banks, under Section 14 of the Federal Reserve Act, may purchase and sell in the open market, at home or abroad, from or to domestic or foreign banks, firms, corporations, or individuals, bills of exchange and bankers' acceptances of the kinds and maturities made eligible for rediscount, with or without indorsement of a member bank.

General Character of Eligible Instruments

The Federal Reserve Board has ruled that to be eligible for such purchase the bill or acceptance:

1. Must conform to the relative requirements of the Board covering rediscounts, except that a banker's acceptance growing out of a transaction involving the storage within the United States of goods which have been actually sold, may be purchased, provided the acceptor is secured by the pledge of such goods

and provided the bill conforms in other respects to the relative requirements of the Board regarding rediscounts.

2. Must have a maturity at the time of purchase of not more than ninety days, exclusive of days of grace, unless it is a bill drawn on a banker, when it may have a maturity of three months, exclusive of days of grace.
3. Must have been accepted by the drawee prior to purchase by a Federal reserve bank unless it is either accompanied and secured by shipping documents or by a warehouse, terminal, or other similar receipt conveying security title or bears a satisfactory banking indorsement.

Statements

A bill of exchange, unless indorsed by a member bank, is not eligible for purchase until a satisfactory statement has been furnished of the financial condition of one or more of the parties thereto.

A banker's acceptance, unless accepted or indorsed by a member bank, is not eligible for purchase until the acceptor has furnished a satisfactory statement of its financial condition in form approved by the Federal reserve bank and has agreed in writing with a Federal

reserve bank to inform it upon request concerning the transaction underlying the acceptance.

Drafts Secured by Foreign Warehouse Receipt

A draft drawn abroad, payable in the United States in dollars and secured by a warehouse receipt covering readily marketable staples stored in a warehouse located in a foreign country, is eligible for acceptance by a member bank and after acceptance, is eligible for rediscount by Federal reserve banks under the provisions of Section 13 of the Federal Reserve Act, but, under the terms of the Board's present regulations, is not eligible for purchase by Federal reserve banks in the open market, under the provisions of Section 14 of the Federal Reserve Act.

Acceptances of Non-Member Trust Companies

Bills drawn on and accepted by a trust company not a member of the Federal Reserve System, where the proceeds are to be used for purchasing raw material or in

the payment of labor, where the goods have not been sold and no warehouse receipt or other instrument can be furnished, are ineligible for purchase by a Federal reserve bank.

Acceptances Under the Laws of New York

New York State Banking Law

The New York State Banking Law permits greater latitude than does the Federal Reserve Act. In New York, state banks and trust companies may issue acceptances without security and without reference to the exportation and importation of goods.

Section 185, subdivision 10, of the New York State Banking Law permits a trust company, and Section 106, subdivision 2 permits a state bank

"To accept for payment at a future date drafts drawn upon it by its customers and to issue letters of credit authorizing the holders thereof to draw drafts upon it or its correspondents, at sight or on time, not exceeding one year."

Section 108 relating to banks and Section 190 relating to trust companies limit the lia-

bilities resulting from extensions of credit by means of letters of credit, acceptance of drafts, or discount or purchase of notes or bills of exchange, or other obligations of any individual, partnership, unincorporated association, corporation or body politic to ten per centum of the capital stock and surplus of such bank or trust company. These restrictions do not apply to loans to, or investments in the interest-bearing obligations of the United States, the State of New York or any city, county, town or village of such State.

Institutions in Boroughs with Population of Two Millions

Where the bank or trust company is located in a borough having a population of two millions or over, its loans to any state, other than the State of New York, or to any foreign nation, or municipal or railroad corporation, subject to the jurisdiction of a public service commission of New York State, may equal but not exceed twenty-five per centum of the capital and surplus of the lending institution.

It may, likewise, lend to any individual, partnership, unincorporated association, or to

any other corporation or body politic amounts not exceeding twenty-five per centum of its capital and surplus, but the liabilities or loans in such case must be upon drafts or bills of exchange, drawn in good faith against actually existing values, or upon commercial or business paper actually owned by the person negotiating same to the lending institution, and be indorsed by such person without limitation; otherwise such liabilities in excess of ten per centum of the capital and surplus and not in excess of an additional fifteen per centum, must be secured by collateral having an ascertained market value of at least fifteen per centum more than the amount of liabilities secured.

Other Institutions

If the bank or trust company is located elsewhere in the State, its loans to any state, other than the State of New York, or to any foreign nation or a municipal or railroad corporation or corporation subject to the jurisdiction of a public service commission of New York State may equal but not exceed forty per centum of the capital and surplus of such institution.

The total liabilities to such institution of any individual, partnership, unincorporated association, or of any other corporation or body politic may equal but not exceed forty per centum of the capital and surplus of such institution, but the liabilities or loans in such case must be upon drafts or bills of exchange drawn in good faith against actually existing values, or upon commercial or business paper actually owned by the person negotiating the same to the lending institution, and be indorsed by such person without limitation; otherwise such liabilities in excess of ten per centum of the capital and surplus and not in excess of an additional thirty per centum, must be secured by collateral having an ascertained market value of at least fifteen per centum more than the amount of liabilities secured.

In computing the total loans to an individual, all loans to any partnership or unincorporated association of which he is a member, made for his benefit or for that of his firm, shall be included. Loans to a partnership or unincorporated association shall include all

those made for its benefit as well as for the individual members, and in loans to a corporation there shall be included all those made for the benefit of the corporation.

Savings Banks in New York

By virtue of recent amendments to the New York banking laws, the deposits and guaranty fund and the income derived therefrom of savings banks may be invested in bankers' acceptances and bills of exchange of the kind and maturities made eligible by law for purchase in the open market by Federal reserve banks, where the same are accepted by a bank, national banking association or trust company, incorporated under the laws of New York State or under those of the United States, and having its principal place of business in the State of New York.

Limitations on Purchases

Under this amendment, savings banks may not invest in such acceptances more than twenty per centum of their assets, less the amount of the available fund held pursuant to the Banking Laws for the purpose of

paying withdrawals in excess of receipts and meeting current expenses, or for the purpose of awaiting a more favorable opportunity for investment.

The aggregate liability of any bank, national banking association or trust company to any savings bank for acceptances held by and deposits made with the latter is limited to twenty-five per centum of the paid-up capital and surplus of such bank, national banking association or trust company.

Not more than five per centum of the aggregate amount credited to the depositors of a savings bank may be invested in the acceptances of or deposited with a bank, national banking association, or trust company of which a trustee of such savings bank is a director.

Market for Acceptances

In New York, where the largest open market for discounts has been established, most of the business is a matter of trading. One banker or broker calls up another and offers or inquires for a certain volume and kind of acceptance; for instance, "\$100,000

Guaranty Trust." In London the method of procedure is similar, but in Paris and other cities, the buying and selling are done in an established exchange which fixes the discount rates.

Beginning of the Market in New York

The acceptance business in the United States had its actual beginning shortly after the outbreak of the European War. When the London market had to restrict its acceptances, owing to the new conditions arising from the war, the Guaranty Trust Company immediately began issuing dollar letters of credit payable in New York.

The great difficulty at that time was the absence of a market for acceptances. At first, when bills were offered from abroad, drawn under the Guaranty Trust Company's dollar letters of credit, the Company itself had to bid for them. Gradually other banks began bidding and this action resulted in lowered discount rates. Later, rates dropped still further until, at the beginning of 1915, the ruling rate was from three per centum to three and one-half per centum. About the

same time, the situation began to clear in the American money market. Bankers and brokers were freely bidding for acceptances, thus showing that a discount market was near at hand and that the only thing lacking was the acceptances. The Guaranty Trust Company supplied this deficiency with the issuance of further acceptance credits for account of its customers. The market soon indicated that it could absorb more, and the result was that the discount rate fell to about two and one-half per centum. A number of brokers who saw the possibilities in this new line of business advertised all over the country recommending the purchase of acceptances. This, together with the amendments to the Federal Reserve Act which have been favorable to this class of paper, has done much to develop the growth of the acceptance market. In this connection, the Sixth Annual Report of the Federal Reserve Board says:

"In its last annual report the Board discussed the subject of acceptances at length and pointed out that there was not in this country any broad acceptance market such as exists in London. The development of

such a market is necessarily a slow process and the burden of its support has fallen during the year 1919, as in previous years, upon the Federal Reserve Banks. This condition will doubtless continue until banks generally begin to invest funds temporarily idle in acceptances and until this method of employing funds appeals to the private investor. The Federal Reserve Banks most actively engaged in the purchase of acceptances in the open market deemed it necessary in the beginning to establish a more favorable rate both for the discount of these bills for member banks and for their purchase in the open market than was established for the discount of commercial paper. This policy merely involved a recognition of the high quality of these credit instruments and was adopted the more readily in order to stimulate the development of a new business with which the American bankers were, as a rule, unfamiliar and which was regarded as essential in upbuilding the Federal Reserve System and in financing the foreign commerce of the United States by American banks instead of by foreign banks.

"In establishing preferential rates for acceptances recognition was given to the fact that bills drawn against actual shipments of commodities and accepted by the strongest banks and bankers of the country were credit instruments of greater value and could therefore command a lower rate than the average of commercial paper coming from miscellaneous banks in the ordinary course of their discount operations."

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Guaranty Trust Co. cop.

Acceptances

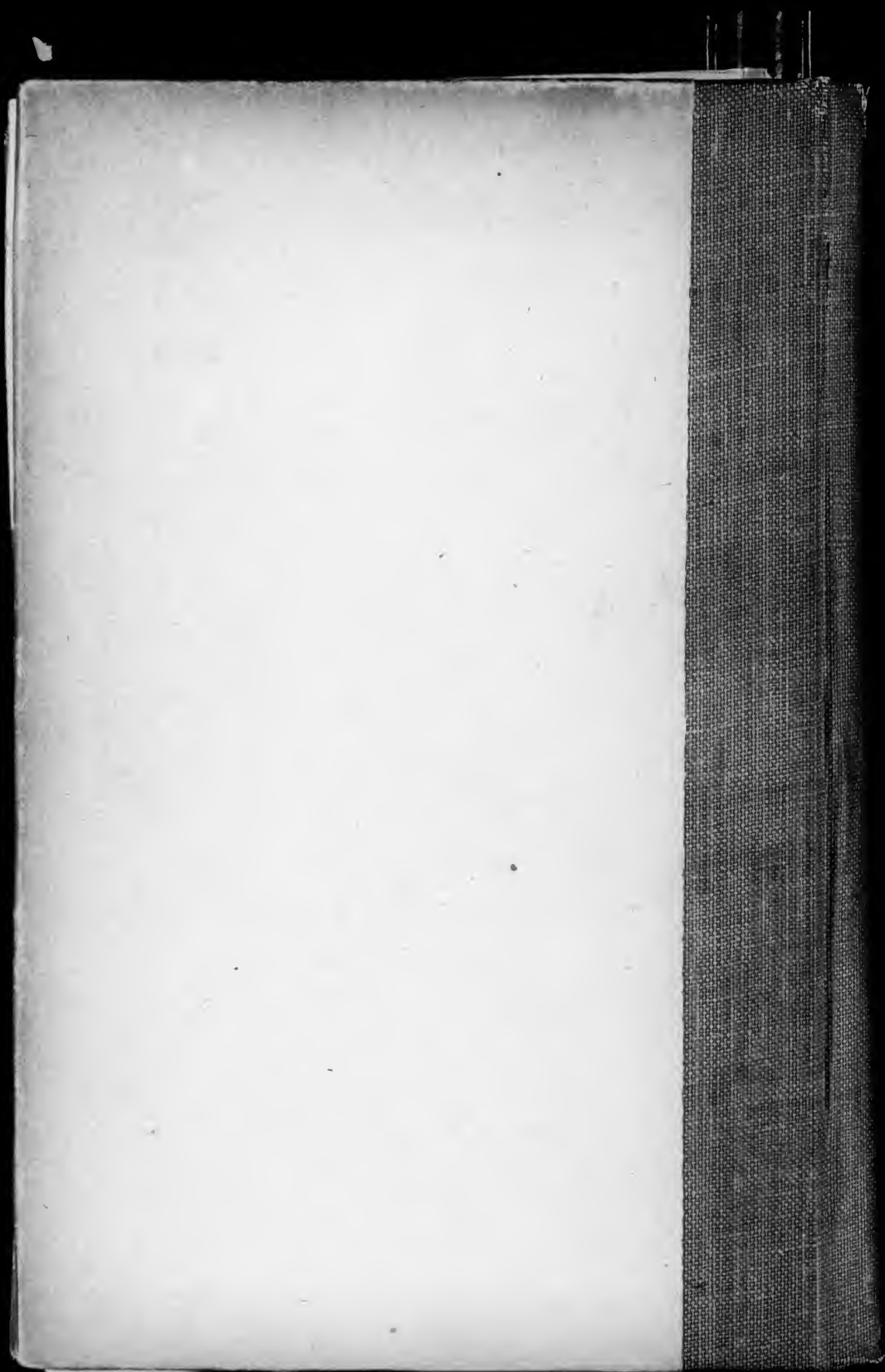
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